

Banks target nation's family jewels, "infrastructure" assets, after destroying economy

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Roads, airports on the block as budgets tighten

NEW YORK (Reuters) - Cash-strapped U.S. state and city governments are likely to sell or lease more highways, bridges, airports and other assets to investors desperate for stable returns after being frazzled by the credit crisis.

The trend is set to pick up speed given worsening budget deficits in state capitals and city halls nationwide.

It will also be welcomed by Wall Street bankers hoping to help create and market so-called "infrastructure" transactions at a time many debt markets remain paralyzed, and after major U.S. stock indexes fell into bear market territory.

"When you are nervous about everything else, you put your money in a toll road," said John Schmidt, a partner at the law firm Mayer Brown LLP in Chicago. "That's the logic of infrastructure. Returns are stable and predictable. You won't get fabulously rich, but you'll get stable cash flow."

The latest enthusiasm for at least partially privatizing infrastructure assets came on July 30 from New York Gov. David Paterson, who is trying to plug a budget deficit caused in part by lower tax revenue as Wall Street retrenches.

"We're just looking at ways to be more efficient and that's why I used the term public-private partnerships -- trying to find some creative solutions," Paterson said. "The reason I'm avoiding taxes is because I think taxes are addictive."

Bankers and others in the industry say there is pent-up demand from dedicated infrastructure funds and public pension funds to invest in hard assets -- perhaps \$75 billion to \$150 billion of equity capital -- but not enough supply.

"Economic conditions are tough, and are going to be very harsh on the performance of state budgets in 2008 and 2009," said Greg Carey, co-head of infrastructure banking at Goldman Sachs Group Inc (GS.N: Quote, Profile, Research). "States are looking for long-term solutions in running businesses. A public-private partnership is a tool in their toolboxes."

A high-water mark came in May, when a group led by Spain's Abertis Infraestructuras SA (ABE.MC: Quote, Profile, Research) and Citigroup Inc (C.N: Quote, Profile, Research) agreed to pay \$12.8 billion to lease the Pennsylvania Turnpike for 75 years. The total could reach \$18.3 billion, including promised improvements. Legislators must approve the lease.

Other transactions have included the \$1.8 billion lease of the Chicago Skyway toll road bridge in 2005, and a \$3.8 billion lease of the Indiana Toll Road the next year. Chicago Mayor Richard Daley is preparing to lease Midway Airport this year.

For Wall Street, infrastructure can be a bright spot at a time of deep job cuts and expected declines in bonuses.

"We've seen an unprecedented number of headhunters recruiting for positions on the buy and sell sides," said Rob Collins, head of Americas infrastructure banking at Morgan Stanley (MS.N: Quote, Profile, Research). "Infrastructure investing can be counter-cyclical to economic trends."

John Ma, the other Goldman infrastructure chief, added: "We're very committed to this space. Our business activity has increased dramatically, even this year."

ALTERNATIVE TO TAX HIKES

According to the nonprofit Center on Budget and Policy Priorities, 29 U.S. states plus the District of Columbia may face a combined \$48 billion of budget deficits in fiscal 2009.

But politicians might be loathe to cut spending or raise taxes at a time mortgage debt, \$4-a-gallon gas and rising food prices leave consumers -- of whom many vote -- dispirited. Tapping public debt markets might also be too costly.

Meanwhile the American Society of Civil Engineers estimates \$1.6 trillion is needed over five years to raise the often aged U.S. infrastructure to "good" condition.

Pennsylvania Gov. Ed Rendell in July called for the United States to establish a capital budget to pay for such repairs. It was a year ago August 1 that the Interstate 35W bridge in Minneapolis plunged into the Mississippi River, killing 13.

Critics say some infrastructure transactions are short-term budget fixes that deprive governments of steady cash streams from taxpayer-funded assets. There is also the risk that private operators won't do their jobs well.

Advocates of privatization say entities might do better managing assets than a government answering to voters.

Politicians could also get a boost if they can take credit for reinvesting sale or lease proceeds in needed projects.

"The argument for a public-private partnership is the private sector is a lot smarter about paying attention to costs, and because it has skin in the game will be more attentive to maintaining an asset over its life," said Joseph Giglio, a privatization expert and professor at Northeastern University's College of Business Administration in Boston.

"Elected officials often shortchange funding of maintenance because they don't want to increase user fees or taxes to pay for it," Giglio added. "Their election cycle is four years. They can pass it on to someone else's watch."

Collins, who also advised Pennsylvania on the turnpike, said infrastructure can also go beyond roads and airports. He said Morgan Stanley is advising Akron, Ohio, on exploring the leasing of its wastewater system, and Indiana on the possibility of private management for its state lottery.

"Lotteries have infrastructure characteristics in that they have stable cash flows and high barriers to entry," he said. "They could even attract private equity investment because they are self-financeable

and require minimal capital expenses."

BIG NAMES

At Goldman, Carey and Ma replaced Mark Florian, who is moving to First Reserve Corp, a private equity firm specializing in energy, a person close to the matter said.

Goldman itself raised a \$6.5 billion infrastructure fund in 2006, and is reportedly trying to raise a \$7.5 billion fund.

Morgan Stanley raised a \$4 billion fund in May. Global Infrastructure Partners, a joint venture between Credit Suisse Group AG (CSGN.VX: Quote, Profile, Research) and General Electric Co (GE.N: Quote, Profile, Research), raised a \$5.6 billion fund the same month. Private equity firm Carlyle Group CYL.UL last year raised a \$1.15 billion fund.

And Kohlberg Kravis Roberts & Co KKR.UL, which is preparing to go public, in May lured George Bilicic from Lazard Ltd (LAZ.N: Quote, Profile, Research), where he led power, energy and infrastructure efforts worldwide, to run its own infrastructure investments.

Two of the largest specialists in the area are Australian: Macquarie Group Ltd (MQG.AX: Quote, Profile, Research) and Babcock & Brown Ltd (BNB.AX: Quote, Profile, Research).

Schmidt, the Mayer Brown partner, said if the Midway transaction succeeds, other airports could also go private, perhaps leading to "lower and more predictable landing fees and terminal rentals for airlines, which certainly aren't flush."

That, he said, could bring the value of roads, bridges and airports that could be privatized to half a trillion dollars.

(Additional reporting by Joan Gralla in New York and Elizabeth Flood Morrow in Albany, New York, editing by Dave Zimmerman)

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